STATE OF MICHIGAN

IN THE SUPREME COURT

INTERNATIONAL BUSINESS MACHINES CORPORATION, Plaintiff/Appellant, v DEPARTMENT OF TREASURY OF THE STATE OF MICHIGAN, Defendant/Appellee.	Supreme Court No. 146440 Court of Appeals No. 306618 Court of Claims No. 11-033-MT

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BRIEF OF PLAINTIFF/APPELLANT INTERNATIONAL BUSINESS MACHINES CORPORATION

ORAL ARGUMENT REQUESTED

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TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES

PAGE(S)

Cases

Michigan Statutes

Federal and Other State Statutes

Constitutional Provisions

Other Authorities

STATEMENT OF JURISDICTION

This Court has jurisdiction under MCR 7.301(2) and the Court's Order of July 3, 2013, granting Plaintiff/Appellant International Business Machines Corporation's Application for Leave to Appeal.

STATEMENT OF QUESTIONS PRESENTED

In granting leave to appeal, this Court directed the parties to include the following four issues among the issues to be briefed:

1. Whether the Plaintiff could elect to use the apportionment formula provided in the Multistate Tax Compact, MCL 205.581, in calculating its 2008 tax liability to the State of Michigan, or whether it was required to use the apportionment formula provided in the Michigan Business Tax Act, MCL 208.1101 *et seq.*? [1]

   Plaintiff/Appellant answers "Yes, Plaintiff could elect to use the apportionment formula in the Compact."

   Defendant/Appellee answers "No, Plaintiff was required to use the apportionment formula provided in the Michigan Business Tax Act."

   Court of Claims answered "No, Plaintiff was required to use the apportionment formula provided in the Michigan Business Tax Act."

   Court of Appeals answered "No, Plaintiff was required to use the apportionment formula provided in the Michigan Business Tax Act."

2. Whether § 301 of the Michigan Business Tax Act, MCL 208.1301, repealed by implication Article III(1) of the Multistate Tax Compact?

   Plaintiff/Appellant answers "No."

   Defendant/Appellee answers "Yes."

   Court of Claims did not answer.

   Court of Appeals answered "Yes."

3. Whether the Multistate Tax Compact constitutes a contract that cannot be unilaterally altered or amended by a member state?

   Plaintiff/Appellant answers "Yes."

   Defendant/Appellee answers "No."

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[1] The statutes at issue here are attached as Attachment A (Multistate Tax Compact, MCL 205.581, as enacted by Michigan and in effect until 2011) and Attachment B (relevant sections of Michigan Business Tax Act, MCL 208.1101 *et seq.*).

Court of Claims did not answer.

Court of Appeals answered "No."

4. Whether the modified gross receipts component of the Michigan Business Tax Act constitutes an income tax under the Multistate Tax Compact?

Plaintiff/Appellant answers "Yes."

Defendant/Appellee answers "No."

Court of Claims answered "No."

Court of Appeals did not answer.

I. INTRODUCTION

The issue in this case is what apportionment formula should be used to determine Plaintiff/Appellant International Business Machines Corporation's tax liability for purposes of the Michigan Business Tax for tax year 2008. Michigan became a party to the Multistate Tax Compact (the "Compact") in 1970. MCL 205.581. In doing so, Michigan agreed to be bound by all of its terms, including the core provision securing for all multistate taxpayers the *election* to apportion income *either* using the formula in the Compact (the "Compact Formula") *or* an alternative state formula (the "State Formula"):

> Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party state . . . may elect to apportion and allocate his income in the manner provided by the laws of such state . . . without reference to this compact, or may elect to apportion and allocate in accordance with article IV.

MCL 205.581, Art III(1); Art IV(9) (three-factor Compact Formula). In 2007, Michigan enacted the Michigan Business Tax Act ("MBTA") (MCL 208.1101 *et seq.*), which contains an apportionment formula that is different than the Compact Formula. MCL 208.1301 (single sales factor formula). Defendant/Appellee Department of Treasury ("Department" or "Defendant") contends that the MBTA overruled and eliminated the right to elect the Compact Formula. To the contrary, under the law governing interstate compacts and statutory interpretation, the MBTA sets forth Michigan's alternative State Formula, as contemplated by the Compact, without affecting the right to elect the Compact Formula.

As a matter of statutory construction, the MBTA did not eliminate the Compact election. The MBTA and the Compact both direct that a taxpayer "shall" use its particular formula to apportion income. Because of the Compact's election provision, the MBTA and the Compact are in harmony — if a taxpayer makes an election under the Compact, the taxpayer "shall" apportion its income pursuant to the Compact Formula (MCL 205.581, Art IV(9)); if the

taxpayer does not make such an election, it "shall" apportion its income pursuant to the MBTA Formula (MCL 208.1301(1-2)).

There is nothing in the plain language of the MBTA or its legislative history to indicate that the Legislature amended the Compact to repeal the Compact election and mandate only the MBTA Formula. Because implied repeal is highly disfavored and only applicable if the competing statutes are irreconcilable and there is clear intent to repeal, the Court of Appeals' holding that the MBTA impliedly repealed the Compact election is wrong.

Even if Michigan had intended to repeal the Compact election, it was prohibited from doing so under the law governing interstate compacts. Compacts are unique instruments used by states to address a wide range of subjects where collective state governance is vital — from child welfare, parole and prisoner transfer, and education, to water resources, environmental concerns, transportation, licensing, and taxation. More than 200 interstate compacts are currently in effect, and Michigan is a party to at least twenty.[2] A large body of federal and state case law, which the Court of Appeals failed to consider, makes clear that a compact is *both* a statute *and* a binding contract among sovereign states by which they committed to exercise their collective sovereignty. Therefore, one party state may not unilaterally repeal or eliminate the terms of an interstate compact piecemeal, and such terms take precedence over state statutes.

The Court of Appeals wrongly held that the Compact "does not appear to constitute a truly binding contract" (i.e., compact). In *United States Steel Corp v Multistate Tax Commission,* 434 US 452; 98 S Ct 799; 54 L Ed 2d 682 (1978), the United States Supreme Court held that this Compact is a valid and binding interstate compact among the signatory states.

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[2] See MCL 3.711 *et seq.* (Interstate Compact on Placement of Children); MCL 388.1301 (Interstate Compact for Education); MCL 400.115r-s (Interstate Compact on Adoption and Medical Assistance); MCL 330.1920 *et seq.* (Interstate Compact on Mental Health); MCL 3.1011 *et seq.* (Interstate Compact for Adult Offender Supervision).

Michigan is obligated to comply with all provisions of the Compact unless it withdraws according to the Compact's terms. Under the law governing interstate compacts, Michigan was prohibited from unilaterally eliminating the core election provision of the Compact, particularly because it is expressly mandatory and is critical to achieving the Compact's stated purposes of providing baseline uniformity in the taxation of multistate businesses and ensuring equitable apportionment. Further, the radical departure from interstate compact law the Department is advancing would jeopardize Michigan's ability to rely on other states adhering to the commitments in other vital interstate compacts.

Under both principles of statutory construction and compact law, Plaintiff properly elected the Compact Formula for the two tax bases of the MBTA — the Business Income Tax base and the Modified Gross Receipts Tax ("MGRT") base. The Compact's election is secured for all income taxes, as broadly defined to include a tax on "an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions." MCL 205.581, Art II(4). The Department agrees that the Business Income Tax base of the MBTA is an income tax under the Compact. The MGRT is imposed on a base of gross income less deductions, many of which are general business expenses and not specifically or directly related to particular transactions. Thus, the MGRT is also an income tax under the Compact.

To prevail, the Department must convince this Court that the MBTA actually eliminated the election as a matter of statutory construction *and*, if so, that Michigan had the authority to unilaterally eliminate the Compact election under compact law. The Department is wrong on both. Accordingly, this Court should reverse the unpublished decision of the Court of Appeals.

II. COMPACT AND STATUTORY FRAMEWORK

To compute a multistate corporation's state tax liability, the taxpayer's total income must be divided between the relevant states. To do this, each state prescribes one or more apportionment formulas which each produce an apportionment percentage, i.e., an apportionment factor. Thus, "apportionment" is the mechanism by which the tax base of a corporation with activities in more than one state is divided between those states to avoid duplicative taxation. See Sharpe, *State Taxation of Interstate Businesses and the Multistate Tax Compact,* 11 Colum J L & Soc Probs 231, 234-38 (1974-75) (Att GG at 4-8). In simple terms, the corporation's tax base is multiplied by the apportionment factor (the number computed by the apportionment formula), and that result is multiplied by the state's tax rate to determine the corporation's state tax liability.

In this case, Plaintiff elected to compute its Michigan tax according to the Compact Formula, i.e., the three-factor apportionment formula set forth in the Multistate Tax Compact at MCL 205.581, Article III(1) and IV(9).[3] Defendant contends no election was available and instead the sole apportionment formula for computing Michigan tax liability was the MBTA Formula, i.e., the single-sales factor apportionment formula set forth in the MBTA at MCL

[3] Under the Compact Formula, Plaintiff would multiply its income and modified gross receipts by this factor:

$$\frac{\frac{\text{Michigan Sales}}{\text{Sales Everywhere}} + \frac{\text{Michigan Property}}{\text{Property Everywhere}} + \frac{\text{Michigan Payroll}}{\text{Payroll Everywhere}}}{3}$$

208.1301.[4]

To resolve this case, the following overview of the Compact and the MBTA is instructive.

A. The History of the Multistate Tax Compact

The Compact was conceived in response to demand for uniformity in state taxation of corporate income. *US Steel, supra* at 454-55. Nonconformity of state tax systems had become a major concern after World War II as corporate taxpayers increasingly expanded their operations across multiple states and state income taxes became more popular but varied widely (including their apportionment formulas) from state-to-state. See HR Rep No 88-1480 (1964) ("Willis Report Vol 1") at 99-103, 118-19 (Att C at 4-7). With the states applying varying apportionment formulas, multistate corporations faced the threat of over-taxation and also tremendous uncertainty and compliance costs. *Id.* at 118-19, 596 (Att C at 7, 23).

1. Uniform Division of Income for Tax Purposes Act

To promote uniformity, in 1957, the National Conference of Commissioners for the Uniform State Laws drafted a model law, the Uniform Division of Income for Tax Purposes Act ("UDITPA"). Willis Report Vol 1 at 132-33 (Att C at 11); Sharpe, *supra* at 241-42 (Att GG at 11-12). UDITPA apportions a multistate corporation's total income to a taxing state by a three-factor apportionment formula of equal-weighted sales, property and payroll factors, but it was not promptly adopted by many states. *Id.*

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[4] The MBTA Formula can be expressed in this way:

$$\frac{\text{Michigan Sales}}{\text{Sales Everywhere}}$$

2. Congressional Involvement

Meanwhile, in 1959, in *Northwestern States Portland Cement Co v Minnesota,* 358 US 450; 79 S Ct 357; 3 L Ed 2d 421 (1959), the Supreme Court surprised the business community with a decision adopting a broad view of the ability of states to tax multistate businesses. Willis Report Vol 1 at 7 (Att C at 2). In response, the business community questioned whether there were any effective limits on state taxation. *Id.* Congress reacted swiftly and for the first time in its history adopted an act, Public Law 86-272, restricting the power of states to tax interstate business. *Id.* at 8 (Att C at 3); 15 USC 381-84.

Congress also ordered a full-scale study of state taxation of multistate business to recommend legislation establishing uniform standards. *US Steel, supra* at 455; Willis Report Vol 1 at 8-9 (Att C at 3); Sharpe, *supra* at 242 (Att GG at 12). In its multi-volume reports issued in 1964-65, the Congressionally-appointed Willis Commission explained the problem:

> Increasingly the States, reinforced by judicial sanction, have broadened the spread of tax obligations of multistate sellers. . . . The expanding spread of tax obligations has not, however, been accompanied by the development of an approach by the States which would allow these companies to take a national view of their tax obligations. The result is a pattern of State and local taxation which cannot be made to operate efficiently and equitably when applied to those companies whose activities bring them into contact with many States.

HR Rep No 89-952 (1965) ("Willis Report Vol 4") at 1127 (Att E at 5); see also Willis Report Vol 1 at 99-103 (Att C at 4-6) (concluding that the lack of uniformity in state taxation unacceptably burdened interstate companies). The Willis Report decried the states' efforts at uniformity and aimed particular criticism at the variation in state apportionment formulas:

> [V]ariation appears to be [formula apportionment]'s most significant historical characteristic. Not only have there always been wide diversities among the various formulas employed by the States, but the composition of those formulas seems to be constantly changing.

Willis Report Vol 1 at 118-19 (Att C at 7) (describing at least eleven different state apportionment formulas as of 1963). See also *id.* at 194, 247-9 (Att C at 14, 16-17) (variance in apportionment formulas causes complexity in compliance and overtaxation). The Willis Report recommended federal legislation to establish uniformity in state taxation and safeguard interstate commerce. See *US Steel, supra* at 455; Willis Report Vol 4 at 1128 (Att E at 6) ("There is every reason to believe that, without congressional action, the worst features of the present system will continue to multiply.").

The Report concluded with specific Congressional legislative recommendations, including a mandatory apportionment formula as the sole method of dividing corporate income among the states, a uniform sales and use tax act, and federal oversight — in short, federal preemption of critical aspects of state taxation. See Willis Report Vol 4 at 1133-38, 1143 (Att E at 7-10); Sharpe, *supra* at 242 (Att GG at 12). Soon after the Report's release, Congress introduced a bill (HR 11798, 89th Cong, 2d Sess (1965)), including one mandatory apportionment formula, to implement these sweeping recommendations. (Att F).

B. The Multistate Tax Compact

Facing this imminent threat of federal preemption in an area long left to state control, the states responded with the Compact. *US Steel, supra* at 454; Sharpe, *supra* at 243 (Att GG at 13) ("With the . . . Willis Bill, it became apparent to state tax administrators that Congress would act if businesses and the states failed to reform the existing system."); Commission 1st Annual Rep at 1 (Att I at 3) ("The origin and history of the [] Compact are intimately related and bound up with the history of the states' struggle to save their fiscal and political independence from encroachments of certain federal legislation introduced in [C]ongress. . ."); Council of State Governments' Compact Summary and Analysis, dated January 20, 1967 (Att H at 4) ("Development of the [C]ompact is the result of . . . the growing likelihood that federal action

will curtail seriously existing State and local taxing power if appropriate coordinated action is not taken very soon by the States.").

The National Association of Tax Administrators convened an "unprecedented" special meeting in January 1966 to oppose HR 11798 and to devise an alternative that would eliminate the need for federal legislation. See Sharpe, *supra* at 244 n 49 (Att GG at 14). Michigan played a key role. Bill Dexter, "a longtime assistant attorney general for taxes in Michigan . . . fathered the idea" of the Compact presented at this meeting "as a means of heading off then-pending federal legislation that the states regarded as intruding on their taxing jurisdiction." Eugene Corrigan, MTC's 40th Anniversary – A Retrospective, 45 State Tax Notes 529 (2007) (Att DD at 1-2). He was pivotal in the drafting of the Compact, along with compact experts from the Council of State Governments and representatives of other organizations including the National Association of Attorneys General. *Id.*; see also Commission 1st Annual Rep at 1 (Att I at 3).

They unveiled the Compact in January 1967. Commission 1st Annual Rep at 2 (Att I at 4). By its terms, the Compact became effective as to all party states upon its enactment by any seven states, only seven months after the final draft. *US Steel*, *supra* at 454. Michigan became a party state to the Compact with the enactment of MCL 205.581 in 1970: "The multistate tax compact is enacted into law and entered into with all jurisdictions legally joining therein . . . ." MCL 205.581 § 1, 1969 PA 343 § 1 (eff July 1, 1970).

By agreeing to be bound by the terms of the Compact, the signatory states intended to satisfy the federal government that a baseline level of uniformity had been achieved. See Commission 1st Annual Rep at 9-10 (Att I at 11-12). Thus, after the Compact became effective, no federal legislation imposing uniformity on the states as proposed in the Willis Report was ultimately enacted.

C. The Compact's Provisions

Article III(1), the provision at issue here, requires states joining the Compact to offer the Compact Formula — UDITPA's equal-weighted, three-factor formula — as an option to taxpayers, but also allows states to craft their own alternative apportionment provisions:

> Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party state . . . may elect to apportion and allocate his income in the manner provided by the laws of such state . . . without reference to this compact, or may elect to apportion and allocate in accordance with article IV.

MCL 205.581, Art III(1). The Compact adopted UDITPA and its equal-weighted, three-factor apportionment formula in Article IV:

> All business income shall be apportioned to this state by multiplying the income by a fraction the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

Id. at Art IV(9).

According to the Supreme Court, Article III "allows multistate taxpayers to apportion and allocate their income under formulae and rules set forth in the Compact *or* by any other method available under state law." *US Steel, supra* at 457 n 6 (emphasis added); see also, *Donovan Constr Co v Dep't of Treasury,* 126 Mich App 11, 20; 337 NW2d 297 (1983) ("[The Compact] provides that a multistate taxpayer may elect to apportion or allocate its income in accordance with state law or may elect to apportion and allocate its income in accordance with Article IV of the [C]ompact."). While a party state may develop its own alternative State Formula (such as a single sales factor formula), it is *required* to allow taxpayers to elect the Compact Formula. See also, Council of State Governments' Compact Summary and Analysis (Att H at 4) ("Each party [s]tate could retain its existing division of income provisions, but it would be required to make [UDITPA] available to any taxpayer wishing to use it."); Commission 3rd Annual Rep at 3 (Att J at 8).

The election applies to all "income taxes," defined as "a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions." MCL 205.581, Art II(4). "Income taxes" is to be interpreted broadly, to better effectuate the purposes of the Compact: "The definitions of "income tax" and of "gross receipts tax" shall be read together. Any doubt as to whether a particular taxing measure falls under one definition or the other shall be resolved in favor of construction as an income tax in order to more effectually make available the application of the substantive provisions of the Multistate Tax Compact." Compact Regulation II.4 (adopted by Commission in 1968; but not adopted by Michigan) (Att K).

Article I enumerates the purposes of the Compact:

1. Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.
2. Promote uniformity or compatibility in significant components of tax systems.
3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.
4. Avoid duplicative taxation.

MCL 205.581, Art I; see also, *US Steel, supra* at 456; MCL 205.581, Art XII (directs that "[t]his compact shall be liberally construed so as to effectuate the purposes thereof."); Council of State Governments 1967 Compact Summary and Analysis (Att H at 4) (discussing importance of election provision to Compact's purposes).

The Willis Report also focused on inequities in state sales and use tax laws. See Willis Report Vol 1 at 9 (Att C at 3). Thus, Article V obligates each party state (a) to provide a full use tax credit to taxpayers who previously paid sales or use tax to another state with respect to the

same property, and (b) to honor tax exemption certificates from other states. MCL 205.581, Art V; Council of State Governments 1967 Compact Summary and Analysis at 2 (Att H at 5).

The Compact leaves certain matters to the states' individual control. It explicitly reserves to the states control over the rate of tax. MCL 205.581, Art XI(a). In addition, like UDITPA, the Compact does not address issues related to determination of a corporation's tax base. See *US Steel, supra* at 457 (explaining that individual member states retain "complete control over all legislation and administrative action affecting the rate of tax, the composition of the tax base (including the determination of the components of taxable income), and the means and methods of determining tax liability and collecting any taxes determined to be due").

The Compact allows withdrawal by party states only through enactment of a statute repealing the Compact:

> Any party state may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party state prior to the time of such withdrawal.

MCL 205.581, Art X(2). And, when a Compact provision is optional, the Compact expressly says so. *Id.* at Art VIII(1) ("This Article [relating to audits by the Multistate Tax Commission] shall be in force only in those party states that specifically provide therefor by statute."); *US Steel, supra* at 457 ("Article VIII applies only in those States that specifically adopt it by statute.").

The Compact established the Multistate Tax Commission (the "Commission") as a vehicle for continuing cooperative action. Each party state must appoint a member to the Commission and pay its share of the Commission's expenses. MCL 205.581, Art VI.1(a), 4(b). The powers of the Commission are set forth in Article VI: to study state and local tax systems, to develop and recommend proposals for greater uniformity, and to compile information helpful to the states. *Id.* at Art VI(3). The Commission may propose uniform regulations relating to

state taxation and submit them to the member states, but "[e]ach such state and subdivision shall consider any such regulation for adoption in accordance with its own laws and procedures." *Id.* at Art VII(3); *US Steel, supra* at 457.

In sum, the Compact's express purposes and provisions reflect a balance struck between uniformity to stave off federal preemption, state flexibility over revenue matters, and taxpayer interests. Although some matters are left to the states by the terms of the Compact (such as tax rate, tax base, and the decision whether to adopt any regulations proposed by the Commission or pursue multistate taxpayer audits), other matters are mandatory and leave no choice to party states but to follow them — the sales and use tax credit; the election to use the Compact Formula; and the obligation to pay dues to the Commission, unless they withdraw from the Compact.

As noted, after the Compact became effective, the federal government was satisfied that a baseline level of uniformity had been achieved, and no federal legislation imposing uniformity on the states as proposed in the Willis Report was ultimately enacted.

D. Background Regarding Apportionment Formulas and the Michigan Business Tax Act

When Michigan enacted the Compact, the Michigan Income Tax Act of 1967 ("Income Tax") imposed the corporate income tax, which was apportioned according to UDITPA, the same three-factor, equally weighted apportionment formula as the Compact. See Section 115 of PA 281 of 1967, codified at MCL 206.115. In 1976, the Single Business Tax ("SBT") replaced the Income Tax on corporations and also initially had a three-factor, equally weighted apportionment formula, just like the Compact. See, e.g., *Trinova Corp v Mich Dep't of Treasury*, 498 US 358, 381; 111 S Ct 818; 112 L Ed 2d 884 (1991). Beginning in the early 1990s, the apportionment formula for the SBT slowly shifted toward a more heavily weighted

sales factor. See, e.g., MCL 208.45 (1975 PA 282; 1991 PA 77); MCL 208.45a (1995 PA 282). Accordingly, it was not until the 1990s that the Compact's election provision — allowing taxpayers to elect the Compact Formula instead of an alternative Michigan formula — was of any benefit to Michigan taxpayers.[5]

In 2007, the Legislature enacted the Michigan Business Tax Act, MCL 208.1101 *et seq* ("MBTA"), effective January 1, 2008, which included the Michigan Business Tax ("MBT"), the tax at issue in this case. The MBT consists of two tax bases: the Business Income Tax ("BIT"), at MCL 208.1201(1), and the Modified Gross Receipts Tax ("MGRT"), at MCL 208.1203(1).

The BIT is imposed "on the business income tax base, after allocation or apportionment to this state, at the rate of 4.95%."

The MGRT is imposed on "the modified gross receipts tax base, after allocation or apportionment to this state at a rate of 0.80%." "Gross receipts" is defined as:

> [T]he entire amount received by the taxpayer as determined by using the taxpayer's method of accounting used for federal income tax purposes, less any amount deducted as bad debt for federal income tax purposes that corresponds to items of gross receipts included in the modified gross receipts tax base for the current tax year or a past tax year phased in over a 5-year period starting with 50% of that amount in the 2008 tax year . . . from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others except for [various exclusions].

MCL 208.1111(1). "Gross receipts" are then reduced by a myriad of deductions collectively referred to as "purchases from other firms." MCL 208.1203(3).

Next, the multistate taxpayer multiplies each tax base by an apportionment percentage computed according to an apportionment formula. As noted, the MBTA Formula consists of only a sales factor. MCL 208.1301(2) ("each tax base of a taxpayer whose business activities are

[5] The SBT was generally considered to be a value-added tax ("VAT"). The question of whether the SBT – VAT or not – fit the Compact's "income tax" definition was never litigated, and Plaintiff expresses no opinion on that question.

subject to tax both within and outside of this state shall be apportioned to this state by multiplying each tax base by the sales factor calculated under section 303.") The MBTA also permits taxpayers to petition for permission to use an alternative apportionment if the prescribed apportionment formula does not "fairly represent the extent of the taxpayer's business activity" in Michigan. MCL 208.1309. (The Compact has a virtually identical provision at MCL 205.581, Art IV(18).) The MBTA also provides for a surcharge of 21.99% of the combined tax due under the BIT and MGRT. MCL 208.1281.

In 2011, the Legislature replaced the MBTA with the Michigan Corporate Income Tax. 2011 PA 39 (effective December 31, 2011). At the same time, the Legislature enacted 2011 PA 40 which provided that effective January 1, 2011, the Compact's allocation and apportionment provisions are no longer applicable to the MBTA,[6] by adding the following language to Article III(1) of the Compact:

> [B]eginning January 1, 2011 any taxpayer subject to the Michigan business tax act, 2007 PA 36, MCL 208.1101 to 208.1601, or the income tax act of 1967, 1967 PA 281, MCL 206.1 to 206.697, shall, for purposes of that act, apportion and allocate in accordance with the provisions of that act and shall not apportion or allocate in accordance with article IV.

MCL 205.581 (Art III(1)) (current version). Accordingly, this Act in 2011, purporting to repeal the election provision of the Compact, was not made retroactive beyond the tax year in which it was enacted.

The new Corporate Income Tax (effective January 1, 2012) also expressed the Legislature's intent to supersede the Compact election: "It is the intent of the legislature that the tax base of a taxpayer is apportioned to this state by multiplying the tax base by the sales factor

[6] Though not squarely at issue in this case, Plaintiff does not concede the validity of this 2011 modification of the Compact.

multiplied by 100% and that apportionment shall not be based on property, payroll, or any other factor notwithstanding section 1 of 1969 PA 343, MCL 205.581." MCL 206.663(3).

III. STATEMENT OF FACTS AND PROCEDURAL HISTORY

A. Factual Summary

Based in Armonk, New York, Plaintiff is in the business of providing information technology products and services worldwide. Apx 48a. On its timely filed MBT Annual Return for the year ended December 31, 2008, IBM elected to apportion its income and modified gross receipts using the Compact Formula pursuant to MCL 205.581, Art IV, in lieu of the MBTA Formula and requested a refund of overpayments made during the tax year. Apx 48a-49a, 56a-59a. Plaintiff claimed a refund of the BIT, MGRT, and surcharge of $5,955,218. Apx 49a, 57a.

The Department denied IBM's refund claim on the basis that IBM was not entitled to elect the Compact Formula and instead re-computed IBM's tax liability utilizing the MBTA Formula under MCL 208.1301. Apx 49a, 68a-71a, 75a.

B. Proceedings Before the Court of Claims

On March 15, 2011, IBM timely filed a Complaint with the Court of Claims, challenging the Department's denial of IBM's election to apportion using the Compact Formula. Apx 44a-71a. On June 16, 2011, IBM filed a Motion for Summary Disposition pursuant to MCR 2.116(C)(10), and the Department filed an Answer in Opposition to IBM's Motion for Summary Disposition, opposing IBM's Motion and supporting grant of summary disposition to Defendant pursuant to MCR 2.116(I)(2). Apx 14a-15a.

The Court of Claims issued an Order Denying Plaintiff's Motion for Summary Disposition and Granting Defendant's Motion under MCR 2.116(I)(2). Apx 35a. In reaching its decision, the Court held:

> The statutes [MCL 205.581 and MCL 208.1101 et. seq] have to be read to give effect to every word and the Plaintiff's argument about the interpretation of the statutes would render several sections of the Michigan Business Tax completely meaningless. First, as I've mentioned, the provision that the Modified Gross Receipts Tax is not an income tax. Second, the provision that apportionment shall be done in accordance with the MBT and third the apportionment relief provision because if the tax payer could simply elect to apportion under the Multi-State Tax Compact then there would be absolutely no use for the apportionment relief provision that puts the burden on the tax payer and requires approval in accordance with the — and as contained — in the Michigan Business Tax.

Apx 33a.

The Court of Claims also denied Plaintiff's Motion for Reconsideration. Apx 36a.

C. Proceedings Before the Court of Appeals

On January 4, 2012, Plaintiff filed a brief in the Court of Appeals, as of right, requesting relief from the judgment of the Court of Claims. Apx 3a. After briefing and argument by the parties, the Court of Appeals issued its opinions on November 20, 2012. Apx 37a-43a. The majority opinion of the Court affirmed the Court of Claims' grant of summary disposition to the Department and held that the MBTA had repealed the Compact's election clause by implication. The Court rejected Plaintiff's argument that the Compact was a binding contract that could not be impaired by subsequent legislation. The Court did not address whether the MGRT constituted an income tax under the Compact as unnecessary to its judgment. Apx 41a.

Judge Riordan of the Court of Appeals concurred separately. Apx 42a-43a. Judge Riordan disagreed with the majority's judgment regarding implied repeal, finding that the MBTA and Compact could be harmonized in the manner argued by the Department.

D. Proceedings Before this Court

Plaintiff's Application for Leave to Appeal was granted by this Court on July 3, 2013.

IV. STANDARD OF REVIEW

This Court reviews de novo a decision on a motion for summary disposition that is based, as here, on a question of law. *Herald Co v Bay City,* 463 Mich 111, 117; 614 NW2d 873 (2000). Additionally, questions of statutory interpretation are questions of law, which this Court reviews *de novo. Id.* at 117-18*; Romain v Frankenmuth Mut Ins Co,* 483 Mich 18, 25; 762 NW2d 911 (2009). Thus, the de novo standard is appropriate for all questions at issue.

V. ARGUMENT

A. THE MBTA DID NOT ELIMINATE THE COMPACT'S ELECTION PROVISION

The MBTA did not eliminate the Compact's election to apportion income using the Compact Formula. Rather, the MBTA Formula in MCL 208.1301(1) sets forth Michigan's *alternative* State Formula for apportionment.

1. MCL 208.1301 and MCL 205.581 Are Readily Harmonized

A court's "main goal when interpreting a statute is to give effect to the Legislature's intent, as expressed in the language of the statute itself." *S Abraham & Sons, Inc v Dep't of Treasury*, 260 Mich App 1, 8; 677 NW2d 31 (2003), citing *STC, Inc v Dep't of Treasury*, 257 Mich App 528, 533; 669 NW2d 594 (2003). "If the statutory language is unambiguous, judicial construction is neither permitted nor required." *Id.*

"It is elementary that statutes in *pari materia* are to be taken together in ascertaining the intention of the legislature, and the courts will regard all statutes upon the same general subject matter as part of I system. In the construction of a particular statute, or in the interpretation of any of its provisions, all acts relating to the same subject, or having the same general purpose, should be read in connection with it, as together constituting one law." *Dearborn Twp Clerk v Jones*, 335 Mich 658, 662; 57 NW 2d 40 (1953), quoting *Remus v Grand Rapids*, 274 Mich 577,

581; 265 NW 755 (1936); see also, *Crawford County v Secretary of State*, 160 Mich App 88, 95; 408 NW 2d 112 (1987) ("Statutes in *pari materia* are those which relate to the same subject matter or share a common purpose. Such statutes must be read together as constituting one law, even if they contain no reference to one another and were enacted on different dates. When interpreting two statutes which arguably cover the same subject matter, they must be construed to preserve the intent of each and, if possible, interpreted in such a way that neither denies the effectiveness of the other. [Citations omitted.]").

The express terms of MCL 208.1301 and MCL 205.581 are unambiguous and readily harmonized so that both statutes are preserved. MCL 205.581, Art III(1) of the Compact requires a party state to allow taxpayers to elect either the Compact Formula or the state's own State Formula. MCL 205.581, Art III(1) ("Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes . . . *may elect to apportion and allocate his income in the manner provided by the laws of such State . . . without reference to this compact, or may elect to apportion and allocate in accordance with Article IV.*") (emphasis added). On the one hand, if a taxpayer elects under MCL 205.581, Art III(1) to use the Compact Formula, "[a]ll business income *shall* be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three." MCL 205.581, Art IV(9) (emphasis added). On the other hand, if a taxpayer does not make the Compact election, "[e]ach tax base of a taxpayer whose business activities are subject to tax both within and outside of this state *shall* be apportioned to this state by multiplying each tax base by the sales factor calculated under section 303." MCL 208.1301(1-2) (emphasis added). Each statute directs that the taxpayer "shall" use its apportionment formula. If this were merely a case of competing "shalls," it might not be

possible to harmonize them. But here, the statutes are harmonized because the Compact's election sits above both apportionment directives: after the taxpayer has made its election, then the relevant formula *shall* apply. *General Motors Corp v Erves*, 399 Mich 241, 255; 249 NW2d 41 (1976) (providing that two statutes "should be read together to harmonize the meaning, giving effect to the Act as a whole").

Similarly, the phrase "[e]xcept as otherwise provided in this act" in MCL 208.1301(1) is readily harmonized with MCL 205.581. This phrase does not refer to the Compact or the Compact election because the Compact is contained in a different act. MCL 205.581, 1969 PA 343. Rather, the phrase accounts for the fact that under "this act" (i.e., the MBTA), taxpayers may be required to or may choose to use a different apportionment or sourcing method from that described in MCL 208.1301(1). For instance, the tax imposed by the MBTA on financial institutions is apportioned based on the "gross business factor," MCL 208.1267(1), and the tax imposed by the MBTA on insurance companies is based on "gross direct premiums written on property or risk located or residing in this state." MCL 208.1235(2). In addition, taxpayers subject to the general business tax imposed by the MBTA may request permission to use an alternative apportionment or sourcing method. MCL 208.1309 (providing for the use of "separate accounting," "the inclusion of one or more additional or alternative factors," or "the use of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base").

The Department's prior briefs and Judge Riordan's concurrence argue that the Compact's election is subordinated within the MBTA's apportionment formula relief provision at MCL 208.1309, which allows use of an alternative apportionment formula only if the taxpayer successfully petitions Defendant for permission. Apx 42a-43a, 108a-110a. MCL 208.1309

applies if the MBTA Formula does not "fairly represent the extent of the taxpayer's business activity in this state." To the contrary, as the Court of Appeals' majority opinion noted, the Compact election and MCL 208.1309 "serve completely different purposes."[7] Apx 39a. The Court of Appeals elaborated:

> MCL 208.1309(1) neither conflicts with nor is rendered meaningless by MCL 205.518. The existence of an election of right under the Compact would not preclude a taxpayer from seeking permission pursuant to MCL 208.1309(1) to use a unique apportionment formula on the basis of fairness; and likewise, no taxpayer would ever need to seek permission under MCL 208.1309(1) to utilize the Compact's apportionment formula, assuming it to be available.

Id. MCL 208.1309(1) did not eliminate or subsume the Compact election. See, e.g., *AFSCME v Detroit*, 468 Mich 388, 399; 662 NW2d 695 (2003) ("[E]very word should be given meaning, and we should avoid a construction that would render any part of the statute surplusage or nugatory.") (citations omitted).

The express terms of MCL 208.1301 and the Compact are in harmony, and the Compact election was not eliminated by the MBTA.

2. The MBTA did not Impliedly Repeal the Compact Election

"Repeals by implication are not favored, as has been well settled by a long line of decisions of the Supreme Court of this State. Where no repealing words are inserted in the act (or amendment) a *strong presumption* arises that no repeal was intended, or it would have been expressed in the act or amendment. [Citations omitted.]" *Saginaw City Council v Saginaw Board of Estimates*, 256 Mich 624, 633; 239 NW 872 (1932) (emphasis added). The intent to repeal must very clearly appear, and courts will not find an implied repeal if they can find

[7] "Both parties agreed that MCL 208.1309(1) is completely distinct, and serves a different purpose, from the Compact election. MCL 208.1309(1) allows a taxpayer to *seek permission*, which may or may not be granted, to use a different apportionment method — and not necessarily one bearing any similarity to the method set forth in the Compact — to avoid some manner of unfairness. At oral argument, this was described as a 'constitutional circuit breaker' to be employed in unusual situations only where the Business Tax Act's default formula would have a 'distortive result.'" Ct of Appeals Op, Apx 39a.

reasonable ground to hold the contrary. *Wayne County Prosecutor v Dep't of Corr*, 451 Mich 569, 576; 548 NW2d 900 (1996), quoting *Attorney General ex rel Owen v Joyce*, 233 Mich 619, 621; 207 NW 863 (1926); *Knauff v Oscoda County Drain Comm'n*, 240 Mich App 485, 492; 618 NW2d 1 (2000) ("When two statutes, claimed to be in conflict, can be reasonably construed harmoniously, this Court must do so rather than find repeal by implication."); *In re Estate of Reynolds*, 274 Mich 354, 360; 265 NW 399 (1936) (repeal by implication only when statutes are "so incompatible that both cannot stand"). In addition, where intent to repeal is doubtful, the statute must be "strictly construed to effectuate its consistent operation with previous legislation" (*Board of County Road Comm'rs v Michigan Public Service Com*, 349 Mich 663, 680-681; 85 NW2d 134 (Mich. 1957), quoting 1 Sutherland, Statutory Construction (3d ed), § 2014), and "'the burden on the party claiming an implied repeal is a heavy one[.]'" *Wayne County Prosecutor, supra* at 576, quoting *House Speaker v State Admin Bd*, 441 Mich 547, 563; 495 NW2d 539 (1993).

Finally, tax statutes in particular must be strictly construed in favor of the taxpayer and against the government. *In re Dodge Bros*, 241 Mich 665, 669; 217 NW 777 (1928) ("*Tax collectors must be able to point to such express authority so that it may be read when it is questioned in court. The scope of tax laws may not be extended by implication or forced construction.* Such laws may be made plain, and the language thereof, if dubious, is not resolved against the taxpayer.") (emphasis added); *Int'l Business Machines v Dep't of Treasury*, 220 Mich App 83, 86; 558 NW2d 456 (1996).

Applying these principles, the MBTA did not repeal the Compact election by implication by simply stating that "[e]ach tax base . . . shall be apportioned [by the State Formula]." MCL 208.1301. First, as discussed, MCL 208.1301 and MCL 205.581 can be readily and reasonably

harmonized to preserve both: if a taxpayer makes the Compact election, the Compact Formula "shall" apply; and if a taxpayer does not so elect, the MBTA Formula "shall" apply. Accordingly, because MCL 208.1301 and MCL 205.581 are not "so incompatible that both cannot stand," *Estate of Reynolds, supra* at 360, there can be no implied repeal.

Second, there is no evidence the Legislature intended to repeal the Compact election when it enacted the MBTA in 2008, and Defendant in the proceedings below did not argue it. The text of MCL 208.1301 lacks any evidence of intent to repeal any part of MCL 205.581. The legislative enactment of the MBTA made no reference to the Compact. See *Rathbun v Michigan*, 284 Mich 521, 544; 280 NW 35 (1938) ("it will not be presumed that the legislature, in the enactment of a subsequent statute, intended to repeal an earlier one, unless it has done so in express terms"). Likewise, the term "shall" in MCL 208.1301(1) is not a repealing word.[8]

Third, subsequent legislative action also confirms the Legislature did not intend the MBTA to repeal the Compact election. In 2011, the Legislature added the italicized language below to the Compact, thereby expressing its intent to eliminate the Compact election beginning January 1, 2011:

> Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party state or pursuant to the laws of subdivisions in 2 or more party states may elect to apportion and allocate his income in the manner provided by the laws of such state or by the laws of such states and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with article IV *except that beginning January 1, 2011 any taxpayer subject to the Michigan business tax act, 2007 PA 36, MCL 208.1101 to 208.1601, or the income tax act of 1967, 1967 PA 281, MCL 206.1 to 206.697, shall, for purposes of that act, apportion and allocate in*

[8] The presumption against implied repeal is so strong that even if the Legislature had expressly stated that MCL 205.581 "shall not apply," that would *not* support repeal by implication. MCL 8.4c provides: "As used in the statutes of this state, 'shall not apply' means that the pertinent provision is not operative as to certain persons or things or in conjunction with a particular date or dates. Use of the phrase 'shall not apply' does not result in the repeal, expiration, termination, or otherwise legislating out of existence of that portion of a statute to which the phrase pertains, but only relates to the operational effect of the provision."

> *accordance with the provisions of that act and shall not apportion or allocate in accordance with article IV. . . .*

MCL 205.581, Art III(1) (as amended by 2011 PA 40; emphasis added). The inclusion of the effective date of January 1, 2011 conflicts with an interpretation of the election as having been superseded in 2008. See *People v Tolbert*, 216 Mich App 353, 360; 549 NW2d 61 (1996) (holding that later amendment of a statute demonstrated the statute was not earlier repealed by implication; "The frank error of the *Young* panel's statutory construction and its implied repeal rationale were proved by the Legislature's reenactment of the Parole Statutes . . . .").

The legislative history for the 2011 amendment (HB 4479) states expressly that the Compact election was still available in 2011:

> House Bill 4479 would amend the MTC to change the way taxpayers are allowed to apportion their activity between the states. *Under current law, a multistate taxpayer can elect to file under the provisions of the MTC rather than the requirements of the laws of states in which it has business activity.* One of these provisions involves how to allocate business activity across the states. The MTC allows a taxpayer to compute an apportionment factor by computing three separate factors. . . . The MBT and the proposed [corporate income tax] use only a sales factor, taking Michigan sales and dividing that amount by the taxpayer's total sales. . . . Under House Bill 4479, any taxpayer subject to either the MBT or the proposed [corporate income tax] would not have the option of using the apportionment factor in the MTC.

Senate Fiscal Agency Analysis for HB 4361, 4362, and 4479, dated May 9, 2011 (Att P at 5-6) (emphasis added); see also Senate Fiscal Agency Analysis for HB 4361, 4362, and 4479, dated May 26, 2011 (Att Q at 5-6) (to the same effect); House Fiscal Agency Analysis for HB 4479, dated March 29, 2011 (Att O) (providing that under the MBT, tax apportionment is based on solely the sales formula and under the Compact, apportionment is based on an equal-weighted, property, payroll and sales formula and stating that "House Bill 4479 would make the MBT or state Income Tax Act apportionment provision apply rather than those in the Multistate Tax Compact."). In addition, both the House and Senate Fiscal Analysis projected a $50 million per

year revenue increase by repeal of the Compact election. *Id.* If the Compact election had been repealed in 2008, there would have been no revenue impact in 2011. See, e.g., *Elias Bros Rests, Inc v Dep't of Treasury*, 452 Mich 144, 152; 549 NW2d 837 (1996) (citing to a Senate Fiscal Agency analysis for a description of the purpose of a bill).

Similarly, when the Legislature enacted the new corporate income tax (effective January 1, 2012), it clearly expressed its intent to supersede the Compact: "It is the intent of the legislature that the tax base of a taxpayer is apportioned to this state by multiplying the tax base by the sales factor multiplied by 100% and that apportionment shall not be based on property, payroll, or any other factor notwithstanding section 1 of 1969 PA 343, MCL 205.581." MCL 206.663(3). "[T]he later express repeal of a particular statute may be some indication that the legislature did not previously intend to repeal the statute by implication." 1A Norman J. Singer & J.D. Shambie Singer, Sutherland Statutory Construction (7th ed), § 23.11.

Finally, even if the Legislature had intended to eliminate the Compact election with MCL 208.1301, it would have been ineffective because the Legislature did not repeal and reenact the provisions of the Compact as required by Article IV, Section 25 of the Michigan Constitution. That section provides: "No law shall be revised, altered or amended by reference to its title only. The section or sections of the act altered or amended shall be re-enacted and published at length." Const 1963, art IV, § 25. The Legislature did not reenact and publish MCL 205.581 to reflect the alleged amendment repealing the Compact election. Accordingly, if MCL 208.1301 was intended to alter the Compact election, it was enacted in violation of Article IV, Section 25 and is without effect. See *Nalbandian v Progressive Mich Ins Co*, 267 Mich App 7, 18; 703 NW2d 474 (2005) (holding that a new Vehicle Code section was invalid because it operated to

amend a section of the Insurance Code (MCL 500.2103(4)(a)(iii)) without any reenactment or republication of the provision).

In light of the express statements and actions of the Legislature indicating that the Compact election remained intact at least until 2011, there is no basis to find that the stringent requirements for implied repeal are satisfied. The Court should reject the argument that the MBTA impliedly repealed the Compact election.

B. THE MULTISTATE TAX COMPACT IS A BINDING INTERSTATE COMPACT THAT CANNOT BE UNILATERALLY ALTERED BY MICHIGAN

Even if the Legislature had tried to eliminate the Compact's election through enactment of the MBTA, it was barred from doing so. An interstate compact like the Compact is a unique type of agreement among states by which they commit to exercise their collective sovereignty in specified ways. Nearly 200 years of interstate compact jurisprudence has established that compacts are both statutes *and* binding agreements between sovereign states. As such, they take precedence over conflicting state law, and states cannot unilaterally alter or amend them piecemeal through subsequent legislation. If a state no longer desires to abide by the terms of an interstate compact, its only recourse is to withdraw pursuant to the compact's terms. In *US Steel,* the Supreme Court determined that the Compact is a valid and binding interstate compact, and this is confirmed by its terms, history and enactment. *US Steel,* supra at 473-79. As a party state to the Compact, Michigan was bound to provide taxpayers with the election to apportion income using the Compact Formula. As a matter of compact law, Michigan was prohibited from altering the Compact, and Plaintiff properly elected to use the Compact Formula in calculating its 2008 tax liability.

1. Under Compact Law, the Compact's Provisions Cannot be Unilaterally Altered or Eliminated by a Party State

Interstate compacts are a crucial mechanism of cooperation among states as equal sovereigns. See, e.g., *Hinderlider v La Plata River Ditch Co*, 304 US 92, 104; 58 S Ct 803; 82 L Ed 1202 (1938) (discussing long-standing use of compacts dating back to Colonial times); *West Virginia ex rel Dyer v Sims*, 341 US 22, 24; 71 S Ct 557; 95 L Ed 713 (1951); Felix Frankfurter and James Landis, *The Compact Clause of the Constitution – A Study in Interstate Adjustment*, 34 Yale L J 685 (1925) (Att EE) (discussing history and expansive uses of interstate compacts). Without interstate compacts, states would need federal legislation or litigation in federal court to solve issues that cross borders. *Hinderlider, supra* at 104; *West Virginia ex rel Dyer, supra* at 27 (encouraging states to use interstate compacts). "Thus, compacts are singularly important because through a compact, the states can create a state-based solution to regional or national problems. . . ." Caroline Broun, et al., The Evolving Use and Changing Role of Interstate Compacts (ABA 2006) ("Broun on Compacts"), § 1.1 at 2-3 (Att CC at 7-8). Interstate compacts address an ever-widening range of subjects, including child support and welfare, parole and prisoner transfer, water resources, environmental concerns, transportation, education, licensing, and taxation. See *id.* at xvi-xvii (Att CC at 4). The Council of State Governments' compact database identifies more than 200 interstate compacts in effect, many without Congressional approval, and Michigan is a member of more than twenty interstate compacts. Att R. See also *US Steel, supra* at 460-71 (recounting long-standing use of compacts).

Through interstate compacts, party states commit to collectively exercise their sovereignty in specified ways, in order to address a shared problem or issue. *Hess v Port Auth*, 513 US 30, 42; 115 S Ct 394; 130 L Ed 2d 245 (1994) ("An interstate compact, by its very nature, shifts a part of a state's authority to another state or states, or to the agency the several

states jointly create to run the compact."); *Green v Biddle,* 21 US 1, 12; 5 L Ed 547 (1823); *West Virginia ex rel Dyer, supra* at 30-31; *KMOV-TV v Bi-State Dev't Agency*, 625 F Supp 2d 808, 811 (ED Mo, 2008); Broun on Compacts, *supra* at 21 (Att CC at 15) (by compact, "the member states have collectively and contractually agreed to reallocate government authority away from individual states to a multilateral relationship"). As a result of this collective exercise of sovereignty, interstate compacts are not mere parallel statutes in each state, or even contracts among private parties, but instead the courts characterize them as simultaneously *both* contracts *and* binding reciprocal statutes among sovereign states. See Broun on Compacts, *supra* at 17-24 (Att CC at 13-17); *Texas v New Mexico,* 482 US 124, 128; 106 S Ct 2279; 96 L Ed 2d 105 (1987); *CT Hellmuth v Washington Metro Area Trans Auth,* 414 F Supp 408, 409 (D Md, 1976); *Doe v Ward,* 124 F Supp 2d 900, 914-15 (WD Pa, 2000); 1 A Singer, Sutherland Statutory Construction (7th ed), § 32:5, p 723 ("When adopted by a state, the compact is not only an agreement between that state and the other states that have adopted it, but it becomes the law of those states as well, and must be interpreted as both contracts between states and statutes within those states."); *Entergy Arkansas Inc v Nebraska,* 358 F3d 528, 541 (CA8, 2004) (compacts are not akin to commercial contracts among private parties but must be interpreted and enforced as contracts among political equals that have unique features and functions in our system of government).

Under the well-developed body of case law referred to as compact law, because an interstate compact represents both a contract and binding reciprocal statutes, the compact takes precedence over other state law, and *one state cannot subsequently unilaterally alter or eliminate a compact's terms piecemeal*:

> Upon entering into an interstate compact, a state effectively surrenders a portion of its sovereignty; the compact governs the relations of the parties with respect to

> the subject matter of the agreement and is superior to both prior and subsequent law. Further, when enacted, a compact constitutes not only law, but a contract which may not be amended, modified, or otherwise altered without the consent of all the parties.

CT Hellmuth, supra at 409. As the Supreme Court directed in *West Virginia ex rel Dyer v Sims*, 341 US 22 (1951), "an agreement entered between states by those who alone have political authority to speak for a state cannot be unilaterally nullified" or altered by any one of the contracting states *Id.* at 23, 28; *Doe v Ward, supra* at 914-15 ("[I]nterstate compacts are the highest form of state statutory law, having precedence over conflicting state statutes. . . . Having entered into a contract, a participant state may not unilaterally change its terms;" finding Parole Compact superseded Pennsylvania Megan's Law statute that imposed additional transfer conditions); *McComb v Wambaugh,* 934 F2d 474, 479 (CA 3, 1991) (overruled on other grounds, *State Dept of Econ Sec v Leonardo,* 200 Ariz 74, 22 P3d 513 (Ariz Ct App, 2001)) ("A compact also takes precedence over statutory law in member states"). In other words, the enactment of the Compact effectively binds subsequent legislatures and prevents them from unilaterally enacting laws that impair or alter Compact obligations (unless the state withdraws from the Compact). *Id.*; see also, *Alcorn v Wolfe,* 827 F Supp 47, 52-53 (D DC, 1993) ("[T]he terms of [] compact cannot be modified unilaterally by state legislation and take precedence over conflicting state law."); *KMOV-TV, supra* at 811-12; *Kansas City Area Trans Auth v Missouri*, 640 F2d 173, 174 (CA 8, 1981); *Nebraska v Central Interstate Low-Level Radioactive Waste Comm*, 902 F Supp 1046, 1049 (D Neb, 1995) (refusing to allow one member state to alter compact's voting provision because "one member state in a compact cannot unilaterally nullify provision of the compact").

The lack of Congressional consent does not change the fundamental principles of compact law barring unilateral, piecemeal alteration. The primary basis for a compact's

precedence over other state laws is the essential nature of compacts as both statutes and binding agreements among sovereign states. If a compact requires and receives Congressional approval, then it is also interpreted as federal law subject to the Supremacy Clause. *Cuyler v Adams,* 449 US 433; 101 S Ct 703; 66 L Ed 2d 641 (1981). This provides an *additional* reason why it cannot be overridden by subsequent state law. See *Alcorn, supra* at 52 ("In light of the Supremacy Clause . . . *and because compacts are analogous to contracts between states,* the terms of the [] compact cannot be modified unilaterally by state legislation and take precedence over conflicting state law.") (emphasis added); Broun on Compacts, *supra* at 65 (Att CC at 19) ("Congressional consent may change the venue in which compact disputes are ultimately litigated; it does not change the controlling nature of the agreement on the member states.").

Ample law confirms that even without Congressional approval, compacts take precedence and party states cannot unilaterally alter them through subsequent legislation. As *McComb v Wambaugh* explains:

> Because Congressional consent was neither given nor required, the [Interstate] Compact [for Placement of Children] does not express federal law. Consequently, this Compact must be construed as state law. Nevertheless, uniformity of interpretation is important in the construction of a Compact because in some contexts it is a contract between the participating states. Having entered into a contract, a participant state may not unilaterally change its terms. A Compact also takes precedence over statutory law in member states.

McComb, supra at 479; see also, *General Expressways, Inc v Iowa Reciprocity Bd,* 163 NW2d 413, 419 (Iowa, 1968) (Att T) (subsequent legislation could not "unilaterally alter the terms of the compact previously entered into by the board"); *In re OM,* 565 A2d 573, 579-80 (DC Ct App, 1989) (Att Y) (signatory to non-approved compact could not unilaterally alter its compact obligations); *In re DB,* 139 Vt 634; 431 A2d 498 (Vt, 1981) (Att V) (holding Interstate Compact on Juveniles was valid and enforceable between party states despite lack of Congressional consent); *In re CB,* 188 Cal App 4th 1024, 1031; 116 Cal Rptr 3d 294 (Cal Ct App, 2010) (Att U)

(non-approved Interstate Compact on the Placement of Children cannot be contradicted or overridden by inconsistent state law).

In addition, the Court of Appeals' treatment of the Compact as a garden-variety statute that can be amended or superseded at will is contrary to Michigan law. Michigan is a party to more than twenty compacts, many of them non-approved, and thus it, too, relies on and enforces the binding nature of party states' compact obligations. See MCL 3.711 *et seq.* (non-approved Interstate Compact on Placement of Children); *In re Lacy,* 2011 Mich App LEXIS 2539, unpublished opinion per curiam of the Court of Appeals, issued Dec. 28, 2010 (Docket No 298305) (Att X at 2) (explaining that state cannot transfer child to another state contrary to terms of the Interstate Compact on Placement of Children); MCL 388.1301 (non-approved Interstate Compact for Education); MCL 400.115r-s (non-approved Interstate Compact on Adoption and Medical Assistance); MCL 330.1920 *et seq.* (Interstate Compact on Mental Health); OAG, 1979-80, No 5773; 1980 Mich AG LEXIS 63 (Sept. 8, 1980) (Att Z) (recognizing importance of non-approved Interstate Compact on Mental Health and enforcing its clear terms requiring patient consent before interstate transfer); MCL 3.1011 *et seq.* (non-approved Interstate Compact for Adult Offender Supervision); *Wem v Dept of Corrections,* 2011 Mich App LEXIS 1250, unpublished opinion per curiam of the Court of Appeals, issued July 7, 2011 (Docket No 297618) (Att BB at 5-6) (reviewing State's compliance with terms of Interstate Compact for Adult Offender Supervision); MCL 3.161 *et seq.* (non-approved Multistate Highway Reciprocal Act); *Parks v Detroit Auto Inter-Insurance Exch,* 426 Mich 191, 199-200; 393 NW2d 833 (1986) (enforcing provisions of Michigan-Tennessee reciprocal highway compact); see also, Att R, listing additional compacts.

For all of these reasons, compact law prohibits Michigan from unilaterally altering its

compact obligations and denying taxpayers the Compact's mandatory election.

2. MCL 205.581 is a Valid and Binding Interstate Compact

a. *US Steel v. Multistate Tax Commission*

In *US Steel,* the United States Supreme Court determined that the Compact is a valid and binding interstate compact and thus part of the long and important history of interstate compacts as crucial mechanisms for states to commit to exercise their collective sovereignty to address interstate problems. *US Steel, supra* at 473-79.

The case was filed in 1972 by a group of multistate corporate taxpayers to challenge the constitutionality of the Compact on various grounds, including that it had not received Congressional consent under the Constitution's Compact Clause. US Const, Article I, § 10, cl 3 ("No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State.") Rejecting the taxpayer's challenges, the Court reasoned that the power of states to exercise their sovereignty and enter into interstate compacts is well-established and limited only by the Compact Clause. *Hinderlider, supra* at 106. The Supreme Court has long recognized that the Compact Clause does not require all compacts to be congressionally approved to be valid and binding upon the party states. *US Steel, supra* at 469-71. Congressional consent is only required if a compact "is directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States." *Id.* at 471 (citing *Virginia v Tennessee,* 148 US 503, 518-19; 13 S Ct 728; 37 L Ed 537 (1893)). Congressional consent was not required for the Compact because it dealt with the traditionally non-federal issue of state taxes, did not grant party states any powers over taxation that they did not already possess individually (and could therefore commit to exercise collectively), and did not delegate sovereign powers to the Commission. *Id.* at 456-58, 471-78. After rejecting the taxpayers' other challenges to the

Compact, the Court upheld the Compact's validity as an interstate compact without Congressional consent. See also, *Asarco v Idaho State Tax Comm'n*, 458 US 307, 311; 102 S Ct 3103; 73 L Ed 2d 787 (1982) (describing the Compact as "[a]n interstate taxation agreement concerning state taxation of multistate businesses.").

b. MCL 205.581 Bears All the Indicia of an Interstate Compact

US Steel should be determinative of MCL 205.581's status as a valid and binding interstate compact, rather than a garden-variety statute that can be amended or superseded at will. In addition, the Compact bears all of the indicia of an interstate compact. First, it is titled the Multistate Tax *Compact* and the term "compact" is used 25 times in Michigan's enactment. MCL 205.581. As discussed above, an interstate compact is a unique type of codified contract specifically used by states to commit to exercise their sovereignty in agreed-upon ways. See § B(1) above; see also, Black's Law Dictionary (6th ed) at 281 ("compact: An agreement or contract between persons, nations or states. Commonly applied to working agreements between and among states concerning matters of mutual concern."). Indeed, the Compact was intentionally drafted and enacted as an interstate compact. Council of State Governments' Compact Summary and Analysis at 7-9 (Att H at 10-12) ("For handling significant problems which are beyond the unaided capabilities of the regularly constituted agencies of individual State governments, the accepted instrument is an interstate compact;" discussing the use of other interstate compacts to address multistate problems). As the Commission stated in 1970, the Compact is "like all compacts" allowing states to accomplish collectively what they cannot do individually. See Commission 3rd Annual Rep at 13 (Att J at 17); Commission 1st Annual Rep at 9-10 (Att I at 11-12) (distinguishing between *individual* action by states in adopting uniform laws and *collective* action of states in enacting the Compact).

The Compact contains numerous other indications of its status as a binding compact and contract. It required enactment by seven party states to become effective. MCL 205.581, Art X(1). It was both "enacted into law *and entered into* with all jurisdictions legally joining therein" by party states, including Michigan. *Id.* at § 1 (emphasis added). It imposes clear obligations on party states – to provide sales and use tax credits and exemptions; to secure all taxpayers the election to use the Compact Formula; and to pay dues to the Commission. *Id.* at Art III-V. In addition, it is express when it allows variations from its terms. For example, the Compact explicitly allows party states not to enact Article VIII's audit provisions. MCL 205.581, Art VIII(1) ("This Article shall be in force only in those party [s]tates that specifically provide therefore by statute."); *US Steel, supra* at 457. And, it created a joint Compact agency, the Commission, with delineated powers. MCL 205.581, Art VI-VIII; *US Steel, supra* at 456-57; see also *Seattle Master Builders Ass'n v Pac Northwest Elec Power Planning Council,* 786 F2d 1359, 1363 (CA9, 1986).

Finally, it specifies the terms for a party state to withdraw from the Compact and mandates that states remain liable for any outstanding contractual obligations:

> Any party State may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party State prior to the time of such withdrawal.

MCL 205.581, Art X. Because party states commit to act collectively over specified matters and cannot unilaterally amend compacts piecemeal, withdrawal provisions are a common feature in modern compacts, setting forth the terms for a state to withdraw and to thereby regain complete sovereignty over the issue. See *Alabama v North Carolina,* 130 S Ct 2295, 2313; 560 US 330; 176 L Ed 2d 1070 (2010) (applying withdrawal provision similar to this Compact); *US Steel, supra* at 473; Broun on Compacts, *supra* at 118 (Att CC at 21) ("Just as important as provisions

governing the entry into force of a compact are those that address the withdrawal of parties and the termination of the agreement.").[9]

In sum, as the Supreme Court determined, the Compact is a valid and binding interstate compact. *US Steel, supra* at 471 (detailing the Compact's obligations and the "multilateral nature of the agreement"); see also *Seattle Master Builders, supra* at 1363 (key indicia of a compact include a joint organization, the inability of a state to modify its participation unilaterally, terms for withdrawal, and provisions which require reciprocal action for their effectiveness).

c. Michigan Law Provides No Basis for a Different Result

In opposition to Plaintiff's Application for Leave to Appeal, Defendant proffered two bases for affirming the Court of Appeals' statement that the Compact "does not appear to constitute a truly binding contract" – that Michigan law requires additional language for the Compact to be binding and that the Compact is an impermissible surrender of the power of taxation under the Michigan Constitution. If adopted, these arguments would represent a radical departure from interstate compact law and would threaten the enforceability of other vital compacts to which Michigan is a party.

Underlying both of these arguments is the premise that Michigan can enter into the Compact and accept its benefits, most importantly avoiding federal preemption, and now argue 40+ years later that it was never actually bound to its Compact obligations. While *McComb v Wambaugh, supra* at 479, indicates that non-approved compacts are interpreted as state law, it directs that such compacts need to be interpreted uniformly across the party states:

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[9] Other Michigan compacts also have similar withdrawal provisions. See MCL 3.1012, Art XIII(A) (Interstate Compact for Adult Offender Supervision); MCL 3.711, Art IX (Interstate Compact on Placement of Children); MCL 330.1920, Art XIII(a) (Interstate Compact on Mental Health).

> Nevertheless, uniformity of interpretation is important in the construction of a Compact because in some contexts it is a contract between the participating states. See *West Virginia ex rel Dyer v Sims,* 341 US 22, 27-28; 95 L Ed 713; 71 S Ct 557 (1951). Having entered into a contract, a participant state may not unilaterally change its terms. A Compact also takes precedence over statutory law in member states.

Under *McComb,* one party state cannot apply its own unique law to shirk its compact obligations. Similarly, in *West Virginia ex rel Dyer,* the Supreme Court refused to allow a party state to avoid its compact obligations by later arguing that it did not have authority under its constitution. *West Virginia ex rel Dyer, supra* at 35 (concurring op) ("Whatever she now says her Constitution means, she may not apply retroactively that interpretation to place an unforeseeable construction upon what the other States to this Compact were entitled to believe was a fully authorized act.").

Moreover, Michigan law does not support a holding that the Compact is not binding. First, the Court of Appeals' cursory analysis that the Compact "does not appear to constitute a truly binding contract" is incorrect. The Court of Appeals and the Department rely on *In re Request for Advisory Opinion Regarding Constitutionality of 2011 PA 38,* 490 Mich 295; 806 NW2d 683 (2011). In this 2011 advisory opinion, this Court determined that by enacting a statutory tax exemption, the Legislature did not create a contractual right to the exemption that could not be subsequently diminished. Because there was no language in any of the statutory tax exemption provisions indicating that the Legislature intended to be contractually bound, the exemptions could be altered by a subsequent legislature. *Id.* at 324.

The advisory opinion did not involve an interstate compact, and the Court of Appeals did not discuss how the principles of the advisory opinion might apply or differ in the context of a compact which is by nature both a contract and a statute. Furthermore, the Compact is distinguishable from the *statute* at issue in *In re Request for Advisory Opinion* because in the

Compact there are clear indicators that the legislators intended to be contractually bound, including the explicit use of the vehicle of an interstate compact with a compact agency, the "entering into" the Compact with other jurisdictions, the requirement of seven party states for the Compact to take effect, the explicit terms for variance and withdrawal, and the clear obligations imposed on the party states. See § B(2)(b) above.

Second, the Court of Appeals' opinion and the Department are wrong that the Compact might violate the constitutional prohibition on surrendering the power of taxation. Court of Appeals Opinion at Apx 48a; Dept's Brief in Opp at Apx 80a. The Michigan Constitution directs that "[t]he power of taxation shall never be surrendered, suspended or contracted away." Const 1963, art 9, § 2. The policy of this provision is to prohibit the *permanent* surrender or contracting away of the state's taxing power. See *Harsha v Detroit*, 261 Mich 586, 596-597; 246 NW 849 (1933); *Home of the Friendless v Rouse,* 75 US 430; 19 L Ed 495 (1869) (permanent tax exemption implicates the surrender provision).

Michigan has not surrendered or contracted away, permanently or otherwise, its power to tax. The Legislature has exercised its inherent power to specify the available methods of apportioning income – it has obligated itself to provide taxpayers with an election to use the Compact Formula or the MBTA Formula until Michigan withdraws from the Compact. MCL 208.1301; MCL 205.581; see also *W A Foote Mem Hosp, Inc v Jackson Hosp Auth,* 390 Mich 193, 215; 211 NW2d 649 (1973) (Legislature's enactment of a tax exemption for hospital property and income was not prohibited; "Rather than abandoning its power of taxation, the Legislature has acted affirmatively and has exercised its power and discretion as explicitly authorized in art 9, § 3 by granting an exemption 'by law' . . ."). The Legislature retains full control of the tax base, the tax rate, its tax revenues and the means and methods of tax collection.

See *US Steel, supra* at 473. Most importantly, the Legislature retains full authority to impose a tax. See *Gaylord v Gaylord City Clerk,* 378 Mich 273, 301; 144 NW2d 460 (1966) (statute imposing an ad valorem tax but not a tax lien did not surrender power of taxation, as "[a] lien is not an essential element of the power of the taxation").

In addition, the Compact is not *permanently* binding. Under the terms of the Compact, Michigan may reclaim *full control* over the apportionment formula by withdrawing from the Compact in accordance with its terms as at least nine other states have chosen to do. *See* MCL 205.581, Art X(2) ("Any party state may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party state prior to the time of such withdrawal."); *US Steel, supra* at 454 n 1 (citing statutes repealing the Compact in Florida, Illinois, Indiana and Wyoming); Nevada ((1981 Nev Stat ch 181, at 350); Maine (PL 332 (2005)); Nebraska (LB 344 (1985)); West Virginia (Act 1985 (160)). The constitutional prohibition against surrender of the power of taxation is not implicated by the Compact.

3. The Compact's Election Provision is Clear and Binding

As a valid interstate compact, the Compact's provisions are binding and cannot be altered or eliminated piecemeal by a party state. Courts are especially vigilant in requiring adherence to compact provisions that are clear and central to a compact's purposes. See *Alabama v North Carolina, supra* at 2313 (directing that courts must closely abide to plain terms of an interstate compact and may not order relief inconsistent with such express terms); *Tarrant Reg Water Dist v Herrmann,* 133 S Ct 2120, 2123; 186 L Ed 153, 167 (2013); *Texas v New Mexico, supra* at 128 (explaining that an interstate compact is a contract and a "legal document that must be construed and applied in accordance with its terms"); *Intl Union of Operation Eng'rs v Del River Joint Toll Bridge Comm'n,* 311 F3d 273, 276 (CA3, 2002) (role of courts is not to rewrite express terms of

agreements entered into by states); OAG, 1978-80, No 5773, *supra* at 2-3 (Att Z) (enforcing plain language of Michigan's obligations under the Interstate Compact on Mental Health). This same principle applies to the interpretation of statutes and contracts. See *AFSCME v Detroit, supra* at 399 ("If the statute's language is clear and unambiguous, we assume that the Legislature intended its plain meaning, and we enforce the statute as written."); *Sheldon-Seatz, Inc v Coles,* 319 Mich 401, 406-7; 29 NW2d 832 (1947). It is particularly imperative for interstate compact interpretation:

> We are especially reluctant to read absent terms into an interstate compact given the federalism and separation-of-powers concerns that would arise were we to rewrite an agreement among sovereign states, to which the political branches consent. As we have said before, we will not order relief inconsistent with the express terms of a compact, no matter what the equities of the circumstances might otherwise invite.

Alabama v North Carolina, supra at 2312-13.

Article III(1), the central provision at issue, *requires* party states to allow taxpayers to elect either the Compact Formula (an equal-weighted, three-factor apportionment formula) or a party state's own alternative State Formula (if the state chooses to enact one).

> Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes . . . may elect to apportion and allocate his income in the manner provided by the laws of such State . . . without reference to this compact, or may elect to apportion and allocate in accordance with Article IV.

MCL 205.581, Art III(1). Article IV then provides the Compact Formula:

> All business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Id. Art IV(9). See *US Steel, supra* at 457 n 6 (this provision "allows multistate taxpayers to apportion and allocate their income under formulae and rules set forth in the Compact or by any other method available under state law."); *Donovan Constr Co, supra* at 20 ("[The Compact]

provides that a multistate taxpayer may elect to apportion or allocate its income in accordance with state law or may elect to apportion and allocate its income in accordance with Article IV of the [C]ompact."). The Compact's requirement that all party states must provide taxpayers with the Compact election is express and unambiguous, and it must be enforced.[10]

The Compact's stated purposes also underscore the fact that the election is a critical component of the Compact: to "[f]acilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases," "[p]romote uniformity," "[f]acilitate taxpayer convenience and compliance," and "[a]void duplicative taxation." MCL 205.581, Art I; *US Steel, supra* at 456. Further, MCL 205.581, Art XII directs that, "[the] [C]ompact shall be liberally construed so as to effectuate the purposes thereof." See also, *Oklahoma v New Mexico,* 501 US 221, 230-31; 111 S Ct 2281; 115 L Ed 2d 207 (1991) (interstate compact must be interpreted consistent with its stated purposes)

The Compact's election provision is central to each of its stated purposes. Ensuring multistate taxpayers the election to apportion across states using the *uniform* Compact Formula facilitates proper determination of their state and local tax liability, equitably apportions their tax bases among states, prevents duplicative taxation, and secures base-line uniformity and compatibility among state tax systems. In addition, using the same formula in multiple states would indisputably make taxpayer compliance simpler and more convenient. As the Council of

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[10] The Commission's view of the Compact as a model law to attempt to avoid this clear language is untenable. Dept's Opp to App for Leave to Appeal at 9. It may operate akin to a model law for states that choose *associate* membership and do not enact and enter into the Compact as full members. See *id.* at 8 (discussing Michigan's associate member status from 1967-70); Commission 1st Annual Rep at 13 (Att I at 15). Once Michigan became a full Compact member, enacting and "enter[ing] into" the Compact in its entirety (MCL 205.581, § 1), it was bound to the Compact's term until it withdrew. In addition, for all the reasons detailed in § B(2)(b) above, the Compact bears all the indicia of a binding compact, not a model law. While the Commission's proposed regulations are only advisory upon party states by the Compact's express terms (MCL 205.581, Art VIII(3)), the obligations to provide reciprocal sales/use tax credits and to honor the Compact election are mandatory ones.

State Governments stated in 1967 when it distributed the Compact for consideration by the states:

> One of the principle measures for improvement – i.e., *simplification of taxpayer compliance* and *elimination of the possibility of double taxation* – in the income tax field is the Uniform Division of Income for Tax Purposes Act. The compact would permit any multistate taxpayer, *at his option*, to employ the Uniform Act for allocation and apportionment involving party states of [*sic*] their subdivisions. Each party state could retain its existing division of income provisions but it would be required to make the Uniform Act available to any taxpayer wishing to use it. Consequently, any taxpayer could obtain the benefits of *multi-jurisdictional uniformity* whenever he might want it.

Council of State Governments memo accompanying final text of the Compact (Att G at 1) (emphasis added); Council of State Governments Compact Summary and Analysis (Att H at 4) (to the same effect).

In addition, as the negotiating history of the Compact makes clear, variation in state apportionment formulas was a primary focus of Congress, and Congress was poised to impose a mandatory apportionment formula on all states, as well as to eviscerate other critical aspects of state authority over taxation. See § I(A)(2) above; Willis Report Vol 1 at 118-19, 247-49 (Att C at 7, 16-17); Willis Report Vol 4 at 1133-64 (Att E at 11-17). By the party states' *guaranteeing* that one uniform apportionment formula would be available to multistate taxpayers, the Compact addressed the key concerns set forth in the Willis Report. *Id.*; Hellerstein, State and Local Taxation (6th ed 1997) at 565 (Att FF) (". . . Compact was developed . . . to offset the severe criticism the Willis Committee leveled against the widespread diversity in state apportionment and allocation methods."); Council of State Governments' Compact Summary and Analysis (Att H at 8-10). In addition, by giving states the flexibility to *also* offer an alternative State Formula, the Compact gained the support of enough party states to take effect and to convince Congress it no longer needed to act. Finally, the Compact's election provision also served taxpayer interests and mitigated the business community's desire for Congressional action, by giving multistate

corporations the ability to choose the apportionment formula that works best for them. See Commission 3rd Annual Rep at 3 (Att J at 8) ("The [] Compact thus preserves the right of the states to make such alternative formulas available to taxpayers even though it makes uniformity available to taxpayers where and when desired."). The binding election provision was at the heart of the deal that was struck to guarantee enough uniformity to stave off Congressional preemption. Commission 1st Annual Rep at 9-11 (Att I at 11-13).

In sum, fundamental principles of compact law and the Compact's express terms, purposes and history compel the conclusion that the Compact election is mandatory and cannot be denied by subsequent state legislation such as the MBTA.

4. The Contract Clause Also Requires Enforcement of the Compact Election

To deny the Compact's mandatory election provision through enactment of a subsequent state law such as the MBTA would violate the Constitutional prohibition on state law that impairs the obligation of contracts. US Const, art I, § 10, cl 1; Const 1963, art I, § 10 ("No . . . law impairing the obligation of contracts shall be enacted."). "[T]he constitution of the United States embraces all contracts . . . a State has no more power to impair an obligation into which she herself has entered, then she can the contracts of individuals." *Green, supra* at 9; *Thompson v Auditor General,* 261 Mich 624, 636; 247 NW 360 (1933) ("The constitutional prohibition embraces all contracts executed or executory whether between individuals or the State and others."); see also, *Washtenak Comm College Educ Assn v Bd of Trustees,* 50 Mich App 467, 471-78; 213 NW2d 567 (1973). The Supreme Court has held that this constitutional prohibition specifically extends to interstate compacts, precluding states from passing laws that impair obligations secured by a compact. *Green, supra* at 12-13; see also, Broun on Compacts, *supra* at

17 (Att CC at 13) ("The Contracts Clause of the U.S. Constitution prohibits the impairment of contracts, and that prohibition extends to interstate compacts.").

In *Green*, the Supreme Court invalidated a Kentucky statute that materially impaired the rights of land owners subject to an interstate compact between Virginia and Kentucky on Contract Clause grounds:

> [T]he duty, not less than the power of this Court, as well as of every other Court in the Union, to declare a law unconstitutional, which impairs the obligation of contracts, whoever may be the parties to them, is too clearly enjoined by the constitution itself, and too firmly established by the decisions of this and other Courts, to be now shaken; and that those decisions entirely cover the present case.
> . . .
> If we attend to the definition of a contract, which is the agreement of two or more parties, to do, or not to do, certain acts, it must be obvious, that the propositions offered, and agreed to by Virginia, being accepted and ratified by Kentucky, is a contract. In fact, the terms compact and contract are synonymous: and in *Fletcher v. Peck*, the Chief Justice defines a contract to be a compact between two or more parties. The principles laid down in that case are, that the constitution of the United States embraces all contracts, executed or executory, whether between individuals, or between a State and individuals; and that a State has no more power to impair an obligation into which she herself has entered, than she can the contracts of individuals. Kentucky, therefore, being a party to the compact which guarantied[sic] to claimants of land lying in that State, under titles derived from Virginia, their rights, as they existed under the laws of Virginia, was incompetent to violate that contract, by passing any law which rendered those rights less valid and secure.

Green, supra at 91-93. See also, *Pennsylvania v Wheeling & Belmont Bridge Co,* 54 US 518; 14 L Ed 249 (1852) (State statute authorizing construction of bridge so as to obstruct navigation on navigable river between that state and another is unconstitutional upon ground that it impairs obligation of contract, where it is contrary to provision of compact made between such states that navigation of river should remain free); *General Expressways, supra* at 420-21 (interpreting later statute to not conflict with compact in order to avoid violation of Contract Clause).

Similarly, in *Doe v Ward,* a federal district court held that a subsequent Pennsylvania statute could not impose additional obligations on a probationer's transfer rights under the Parole

Compact, citing compact law as well as the Contract Clause. *Id.* at 914-15 and n 20 ("the Contract Clause of the United States Constitution protects compacts from impairment by the states"). Thus, an attempt by a party state to eliminate a core obligation established under an interstate compact by subsequent statute violates the Contract Clause.

The Contract Clause also prohibits Michigan from denying taxpayers the Compact's mandatory election.[11]

C. THE MGRT COMPONENT OF THE MBTA CONSTITUTES AN INCOME TAX UNDER THE COMPACT

The Compact election is available to "[a]ny taxpayer subject to an *income tax*." MCL 205.581, Art III(1) (emphasis added). The Department agrees that the BIT base of the MBTA is an "income tax" as defined under the Compact. Complaint, Apx 50a (¶ 15); Dept's Answer to Complaint, Apx 75a (¶ 15); Dept's Brief to Ct of Appeals, Apx 96a. "Income tax" is a defined term under the Compact. Thus, whether the MGRT base of the MBTA is an "income tax" under the Compact depends solely on whether the MGRT meets the Compact's definition of "income tax."[12] It does.

1. Definition of "Income Tax"

The Compact defines an "income tax" as:

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[11] In opposition to Plaintiff's Application for Leave, Defendant argued that Plaintiff taxpayer did not have standing to raise this Contract Clause argument. Plaintiff is not pursuing a breach of contract claim; rather, Plaintiff's complaint is for refund of taxes illegally collected, claims it unquestionably has standing to pursue. As part of its refund action, Plaintiff has every right to argue for the proper determination of its tax liability, including the proper apportionment formula, and for an interpretation that comports with the Constitution and with the status of MCL 205.581 as an interstate compact.

[12] The Department acknowledges "income tax" is not a term of art with a single meaning: while it disputes that the MGRT is an income tax under the Compact, *the Department admits that the MGRT is an income tax under the Financial Accounting Standards Board's FAS 109*. Dept's Answer to Complaint, Apx 76a (¶ 22).

> [A] tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, 1 or more forms of which expenses are not specifically and directly related to particular transactions.

MCL 205.581, Art II(4).[13] The Compact itself provides no other explicit guidance or definitions of the terms and phrases within its definition of income tax. While not adopted by Michigan, Compact Regulation II.4 informs the meaning of the term income tax because it was drafted nearly contemporaneously with the Compact itself:[14]

> The definitions of 'income tax' and of 'gross receipts tax' shall be read together. *Any doubt* as to whether a particular taxing measure falls under one definition or the other *shall be resolved in favor of construction as an income tax* in order to more effectually make available the application of the substantive provisions of the Multistate Tax Compact.

Att K (emphasis added).

The Compact defines "gross receipts tax" as:

> [A] tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which *no deduction is allowed which would constitute the tax an income tax.*

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[13] By the inclusion in the definition of taxes *measured by* net income, it is evident that the tax need not be labeled an income tax, or even a tax on income, in order to be such for purposes of the Compact. The Legislature's statement that "[t]he [MGRT] . . . is upon the privilege of doing business and not upon income or property," (MCL 208.1203(2)) has no bearing on whether the MGRT is measured by net income for purposes of the Compact. As the United States Supreme Court said, and this Court later affirmed, "[t]he name by which the tax is described in the statutes is, of course, immaterial." *Dawson v Kentucky Distilleries & Warehouse Co*, 255 US 288, 292; 41 S Ct 272; 65 L Ed 638 (1921); *Goodenough v Dep't of Revenue*, 328 Mich 56, 66; 43 NW2d 235 (1950) (quoting *Dawson*). *See also, Trinova, supra* at 374 ("A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." (citation omitted)); *New York v Feiring*, 313 US 283, 285; 61 S Ct 1028; 85 L Ed 1333 (1941). Similarly, it is irrelevant how academics characterize the tax, particularly when applying theory rather than the Compact definition. See, e.g., Dept's Opp to App for Leave to Appeal at 26-27.

[14] The regulation was adopted by the Multistate Tax Commission in 1968. See Corrigan, *supra* at 2 (Att DD); Commission First Annual Rep at 6, 8 (Att I at 8, 10).

MCL 205.581, Art II(6) (emphasis added). In other words, a gross receipts tax has either no deductions, or only deductions which would NOT make it an income tax, i.e., any deduction must be specifically and directly related to a particular transaction.

There is a strong implication from the direction to read the definitions of income tax and gross receipts tax together, and in the circular construction of the two definitions (i.e., the way in which the gross receipts tax definition references income tax), that the definitions of income tax and gross receipts tax are binary – a tax on business activity is either one or the other. In that case, while a tax whose computation begins with gross receipts and has no deductions that "are not specifically and directly related to particular transactions" would be a gross receipts tax, a tax whose computation begins with gross receipts and has one or more of such deductions would constitute an income tax. See Compact Reg II.4 (Att K) (directing that "income tax" and "gross receipts tax" be read together); *Dearborn Twp Clerk, supra* at 662 (providing that statutes in *pari materia* "are to be taken together in ascertaining the intention of the legislature").

This interpretation of an "income tax" also results from the plain language of its definition as including a tax whose base is "gross income [less expenses], 1 or more forms of which expenses are not specifically and directly related to particular transactions." MCL 205.581, Art II(4). The Willis Report, which was the impetus for the Compact, confirms that "gross income" was commonly equated with "gross receipts." The Willis Report notes that "gross intake" is sometimes expressed as "gross receipts," sometimes as "gross proceeds of sales" and sometimes as "gross income." Willis Report Vol 3 at 1014 (Att D at 2). Accordingly, at the time the Compact was drafted and enacted, it was understood that "gross income"

commonly meant all receipts.[15]

For a tax to be an income tax under the Compact, there have to be some deductions from gross income, at least one of which is "not specifically and directly related to particular transactions." While the Compact also does not define the phrase "not specifically and directly related to particular transactions," the terms used in this phrase are clear and unambiguous. See *AFSCME v Detroit, supra* at 399 ("If the statute's language is clear and unambiguous, we assume that the Legislature intended its plain meaning, and we enforce the statute as written."). "Particular," "specifically," and "directly" all connote the closest possible relationship to a transaction. They are near synonyms, and by using all three of these words, rather than only one or two, the Legislature underscored its intent and drew this category of expenses especially narrowly.[16] Plain language, and common sense, make clear that the broad category of expenses that are "not specifically and directly related to particular transactions" are expenses that benefit many transactions, or the business generally. Accordingly, the text of the Compact's definition of "income tax" also confirms that a tax on gross receipts less non-transaction specific deductions is an income tax.

As explained below, the MGRT is an income tax for purposes of the Compact because its computation begins with gross receipts, which then are reduced by a myriad of exclusions and

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[15] Examples of states defining "gross income" broadly at that time include Hawaii and Arizona: Hawaii defined "gross income" as "the gross receipts . . . the taxpayer received as compensation for personal services and the gross receipts of the taxpayer derived from trade, business, commerce, or sales . . . *and without any deductions on account of the cost of property sold, the cost of materials used, labor cost, taxes, royalties, interest, or discount paid or any other expenses whatsoever.*" Hawaii Rev Stat 237-3 (as quoted in *Pratt v Kondo*, 53 Haw 435, 436 n.2; 496 P2d 1 (Hawaii, 1972) (Att AA)). Arizona defined "gross income" as "the gross receipts of a taxpayer." Ariz Rev Stat 42-1301 (as quoted in *Ebasco Servs v Arizona State Tax Comm'n,* 105 Ariz 94, 96; 459 P2d 719 (Ariz, 1969) (Att S)).

[16] The Willis Report identified as typical deductions in gross receipts taxes bad debt expenses, cash discount expenses, and trade-in allowances. See Willis Report Vol 3 at 1015-1016 (Att D at 3-4). These are all related to specific transactions, i.e., they arise directly from a sale of certain goods or services to a particular customer.

expense deductions at least some of which are not specifically and directly related to particular transactions.

2. The MGRT Satisfies the Compact's "Income Tax" Definition

The MGRT base is "gross receipts . . . less purchases from other firms . . . ." MCL 208.1203(3). "Gross receipts" is defined as "the entire amount received by the taxpayer from any activity," less "any amount deducted as bad debt for federal income tax purposes" and excluding certain other amounts. MCL 208.1111(1). As an example of an exclusion, when a capital asset (as defined at IRC 1221(a)) or land used in a trade or business (as defined at IRC 1231(b)) is sold, only the *gain* from that sale is included in the MGRT definition of "gross receipts." MCL 208.1111(1)(p).

After the initial calculation of "gross receipts," the next step in computing the *modified* gross receipts tax base is to deduct "purchases from other firms." "Purchases from other firms" includes:

- "inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory,"
- "assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes," and
- "to the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel." MCL 208.1113(6)(a)-(c).

Within each of these three categories are many expenses that are not specifically and directly related to particular transactions.

Inventory is defined as "[t]he stock of goods held for resale in the regular course of trade of a retail or wholesale business . . ." and "[f]inished goods, goods in process, and raw materials

of a manufacturing business purchased from another person."[17] MCL 208.1111(4)(a)-(b). Since "inventory" encompasses all the goods purchased for resale – and thus encompasses expenses incurred *before any particular transaction is contemplated* – these inventory expense deductions are general expenses and not "specifically and directly related to particular transactions." MCL 205.581, Art II(4).

Also deductible from gross receipts are assets acquired during the year that are "eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes." By definition, this deduction is for items – often equipment, such as manufacturing equipment or trucks for delivery– that will have a useful life of multiple years, and thus is a general business expense, deductible regardless of its use in a specific transaction, rather than specifically and directly related to particular transactions. See, e.g., 26 USC 167-168 (depreciation and deprecation method).

Further deductible are materials and supplies, which are similarly items for the benefit of the business organization generally rather than specifically and directly related to particular transactions. For example, the Department's Michigan Business Tax Frequently Asked Questions note that "a physician's or dentist's purchase of sterilizing solution during the tax year . . . may be considered materials and supplies . . . ." Att M at 7 (question M17). Plainly, the sterilizing solution is not purchased on a patient-by-patient basis, but is purchased for use as needed throughout the year.

Thus, the MGRT squarely fits the Compact's "income tax" definition: it starts broadly with all monies received and then is reduced by exclusions and deductions, including by

[17] Within specialized industries, additional items are included in inventory. See MCL 208.1111(4)(c)-(d).

expenses related to inventory, depreciable assets, and materials and supplies — expenses irrefutably *not* specifically and directly related to particular transactions. If there remained any doubt about the MGRT fitting the Compact definition, the contemporaneously drafted Compact regulation directs that the doubt would be "resolved in favor of construction as an income tax." Compact Reg II.4 (Att K). See also *In re Dodge Bros*, *supra* at 669 ("[Tax] laws may be made plain, and the language thereof, if dubious, is not resolved against the taxpayer.")

3. The MGRT Is Not a "Gross Receipts Tax" Under the Compact

That the MGRT is not a gross receipts tax under the Compact lends further support to the conclusion that it is an income tax.

The Compact defines "gross receipts tax" as:

> [A] tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which *no deduction is allowed which would constitute the tax an income tax.*

MCL 205.581, Art II(6) (emphasis added). As established above, the MGRT has many deductions that are NOT specifically and directly related to particular transactions, so it is NOT a gross receipts tax under the Compact.

VI. CONCLUSION AND RELIEF REQUESTED

The Legislature did not intend to repeal the Compact election when it enacted the MBTA; even if the Legislature had intended such a repeal, it had no power to do so under compact law; and both the Business Income Tax base and the MGRT base of the MBTA are income taxes to which the Compact election applies. Accordingly, Plaintiff respectfully requests that this Court

reverse the decision of the Court of Appeals and rule that Plaintiff properly apportioned its entire Michigan tax pursuant to the Compact Formula.

Respectfully submitted,

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